

ORIGINAL

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

RECEIVED

OCT - 7 1998

FEDERAL COMMUNICATIONS COMMISSION
RECEIVED FOR THE SECRETARY

In the Matter of)

Petition of U S West Communications, Inc.)

for Forbearance from Regulation as a)

Dominant Carrier in the Phoenix, Arizona MSA)

CC Docket No. 98-157

MCI WORLDCOM OPPOSITION

MCI WORLDCOM, INC.

Alan Buzacott
Henry G. Hultquist
1801 Pennsylvania Ave., NW
Washington, DC 20006
(202) 887-3204

October 7, 1998

No. of Copies rec'd 0+4
List ABOVE

TABLE OF CONTENTS

Summary	1
I. Introduction	1
II. U S West Possesses Market Power in the Provision of High-Capacity Services in Phoenix	3
A. U S West's Definition of the Product and Geographic Market	6
B. Market Power Assessment	9
C. U S West Possesses Market Power	21
IV. U S West's Petition Does Not Satisfy the Section 10 Criteria	22
A. Dominant Carrier Regulation is Necessary to Ensure that U S West's High Capacity Rates are Just, Reasonable, and Not Unreasonably Discriminatory	23
B. Dominant Carrier Regulation is Necessary for the Protection of Consumers	24
C. Forbearance from Applying the Commission's Price Cap, Tariffing, and Rate Averaging Rules is Not Consistent with the Public Interest	25
V. Pricing Flexibility Issues Should be Examined, if at all, in a Rulemaking	26
VI. Conclusion	28

SUMMARY

The Commission should deny U S West's petition for forbearance because U S West's petition fails to satisfy the three statutory criteria outlined in Section 10 of the Act. Because U S West continues to possess market power, the Commission's tariffing, price cap, and rate averaging requirements remain necessary to ensure that U S West is charging just, reasonable, and not unreasonably discriminatory rates in the Phoenix MSA.

Contrary to U S West's claims of widespread competition, the record shows that U S West's high capacity customers have no alternative sources of supply on most routes in the Phoenix MSA. No more than six percent of the high-capacity locations in the Phoenix MSA are served by a competitive provider of high-capacity services. Competitors cannot provide service to additional locations without substantial investments of time and money; because competitors are unlikely to devote a disproportionate share of their limited resources to the Phoenix MSA it is unlikely that the prospect of additional competitive network buildout is constraining U S West's pricing of high-capacity services.

Consistent with the limited scope of competitive alternatives, U S West's high capacity prices have been increasing, and its service quality decreasing. Given the limited sources of competitive supply, and the fact that U S West has shown itself able to increase prices and reduce service quality, the Commission should find that U S West continues to possess market power in the Phoenix area market for high capacity services.

Because U S West continues to possess market power in the provision of high-capacity services in Phoenix, the Commission should conclude that U S West has failed to satisfy the Section 10(a)(1) criterion. The Commission has previously found that its price cap rules (or other forms of rate regulation) and dominant carrier tariff rules are not necessary only when a carrier does not possess market power. Furthermore, the Commission has recognized that a firm with market power is able to engage in conduct that may be anticompetitive or otherwise inconsistent with the public interest.

The Commission should deny U S West's petition as quickly as possible, in order to forestall a flood of "me too" petitions from other ILECs. The competitive conditions in the Phoenix market are typical of competitive conditions in other metropolitan areas: limited facilities-based competitive entry with circuits terminating to a few buildings in the central business district. Rejection of U S West's petition would make clear that this level of competition does not warrant forbearance from the Commission's dominant carrier regulations.

The limited competition in the Phoenix MSA and other metropolitan areas is consistent with the scope of competitive entry contemplated during the expanded interconnection proceedings. To the extent that the Commission believes that it is appropriate to examine further pricing flexibility for U S West and other ILECs, it should do so in the CC Docket No. 96-262 access reform proceeding. Nothing in the record of this proceeding indicates that competitive conditions in the Phoenix MSA warrant special consideration.

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554**

In the Matter of)	
)	
Petition of U S West Communications, Inc.)	CC Docket No. 98-157
for Forbearance from Regulation as a)	
Dominant Carrier in the Phoenix, Arizona MSA)	
)	

MCI WORLDCOM OPPOSITION

I. Introduction

MCI WorldCom, Inc. (MCI WorldCom) hereby submits its opposition to the petition for forbearance filed by U S West Communications, Inc. (U S West) on August 24, 1998 in the above-captioned docket.

The Commission should deny U S West's petition for forbearance because U S West's petition fails to satisfy the three statutory criteria outlined in Section 10 of the Act. As shown below, the tariffing, price cap, and rate averaging requirements (1) are necessary to ensure that U S West is charging just, reasonable, and not unreasonably discriminatory rates in the Phoenix MSA; (2) are necessary to protect consumers from paying rates that are not just and reasonable; and (3) are consistent with the public interest.

The Commission's dominant carrier tariff, price cap, and rate averaging requirements remain necessary because U S West continues to possess market power in the Phoenix market for high capacity services. Contrary to U S West's claims of

widespread competition, the record shows that U S West's high capacity customers have no alternative sources of supply on most routes in the Phoenix MSA. Because customers do not have alternative sources of supply for high capacity circuits, U S West continues to have the ability "raise prices above competitive levels and maintain that price for a significant period, reduce the quality of the relevant product or service, reduce innovation or restrict output profitably."¹

The extent of competition in the Phoenix area market for high capacity services - - limited competition on a few routes in the central business district -- is in most respects typical of metropolitan service areas in general. The rules adopted in the expanded interconnection proceedings, particularly the density zone pricing provisions, were crafted precisely to address the early stages of competition that universally characterize these metropolitan areas. To the extent that competition has advanced beyond the point contemplated by the expanded interconnection orders, which does not appear to be the case in the Phoenix MSA, any changes to the dominant carrier rules should be considered in a comprehensive rulemaking proceeding, not on a city-by-city basis.

Indeed, the Phoenix MSA does not stand out in any way from the two prior cases in which the Commission reviewed competition in the access markets, the former NYNEX's "Universal Service Protection Plan" and Ameritech's "Customers First"

¹See In the Matter of COMSAT Corporation, File No. 60-SAT-ISP-97, Order and Notice of Proposed Rulemaking, rel. April 28, 1998, at ¶67 (Comsat Order).

plan.² What is remarkable is that in both these cases, dominant carriers sought only limited waivers designed to replace the prescribed access structure with a different system of rate elements, allegedly designed to help the carrier compete in the access market on a fair basis. Here, by contrast, U S West is asking the Commission to abandon access regulation on the strength of facts no more compelling than in those two prior cases.

The Commission has recently asked parties to refresh the record in the CC Docket No. 96-262 access reform proceeding.³ The Commission should deny U S West's petition quickly and ask U S West to raise the issues outlined in its forbearance petition in that proceeding. MCI WorldCom agrees that, putting aside the merits of U S West's forbearance petition, the Commission should consider adopting a paradigm for future pricing flexibility for ILECs, if only to forestall repeated and disjointed efforts by the ILECs to be treated in some respect as a nondominant carrier.

II. U S West Possesses Market Power in the Provision of High Capacity Services in Phoenix

In its petition, U S West requests that the Commission exercise its authority under Section 10 of the Act to forbear from regulating U S West as a dominant carrier in

²In the Matter of the NYNEX Telephone Companies Petition for Waiver, Memorandum Opinion and Order, 10 FCC Rcd 7445 (1995) (USPP Order); In the Matter of Ameritech Operating Companies Petition for a Declaratory Ruling and Related Waivers to Establish a New Regulatory Model for the Ameritech Region, Order, 11 FCC Rcd 14028 (1996) (Customers First Order).

³Public Notice, FCC 98-256, October 5, 1998.

the provision of high capacity services in the Phoenix, Arizona Metropolitan Statistical Area (MSA). In particular, U S West seeks forbearance from: (1) the requirement that incumbent LECs file tariffs for interstate access services (U S West seeks nondominant treatment and permissive detariffing); (2) Sections 61.38 and 61.41-61.49 of the Commission's rules, which require dominant carriers to file tariffs on up to 15-days notice (when filed pursuant to Section 204(a)(3) of the Act) with cost support; (3) Section 69.3(e)(7), which requires averaged rates within a study area; (4) Sections 61.41-61.49 and Part 65, which impose price cap and rate of return regulation on dominant carriers; and (5) "any other rules that apply to U S West, but not other providers, in the Phoenix area market for high capacity services."⁴ If U S West's petition were to be granted, U S West could elect to file no tariffs at all for high capacity services, engaging in customer-specific pricing that is not available to similarly-situated customers.

In evaluating U S West's petition under Section 10, the Commission must first determine whether its price cap, tariffing, and rate averaging requirements are no longer necessary to ensure that U S West's high capacity rates and practices in the Phoenix MSA are just, reasonable, and not unreasonably discriminatory.⁵ According to Commission precedent, the price cap and dominant carrier tariffing regulations can be eliminated (in the case of price cap regulation) or replaced by less onerous regulation (in the case of tariffing) if a carrier is "non-dominant" (i.e., does not have market power in

⁴U S West Petition at 34-35.

⁵47 U.S.C. §10(a).

the relevant market).⁶ Thus, evaluation of U S West's petition requires that the Commission conduct an assessment of U S West's market power in the market for high capacity services in the Phoenix MSA.

In its petition, U S West urges the Commission to find that it does not possess market power in the Phoenix area market for high capacity services. U S West claims that the tariffing, cost support, and rate averaging rules are not necessary because "[m]arketplace forces will effectively preclude U S West from charging unreasonable rates for high capacity services in the Phoenix MSA,"⁷ and that "[t]he Commission can address any issue of unlawful rates or practices through the exercise of its authority to investigate and adjudicate complaints under Section 208."⁸

Contrary to U S West's claims, however, application of the Commission's well-established framework for analyzing market power demonstrates that U S West continues to possess market power in the provision of high-capacity services in Phoenix. The reality is that competitors' networks are of limited scope, and currently provide competitive alternatives on only a few high-capacity routes in the central business district of Phoenix. These limited competitive alternatives are insufficient to constrain U S West's pricing of high-capacity services in the Phoenix MSA or to eliminate the potential for unreasonable discrimination in U S West's dealings with access purchasers.

⁶In the Matter of Motion of AT&T Corp to be Reclassified as a Non-Dominant Carrier, Order, 11 FCC Rcd 3271 (1995) (AT&T Reclassification Order); Comsat Order.

⁷U S West Petition at 36.

⁸Id. at 37.

A. U S West's Definition of the Product and Geographic Market

In the Commission's analysis of market power, the first step is to determine the relevant product and geographic markets. U S West argues that the relevant market is the market for high-capacity circuits provisioned at capacities of DS1 and above in the Phoenix MSA.

1. Product Market

The Commission defines a relevant product market as a service or group of services for which there are no close demand substitutes.⁹ To determine relevant product markets, the Commission must consider whether, if, in the absence of regulation all carriers raised the price of a particular service or group of services, customers would be able to switch to a substitute service offered at a lower price

In its petition, U S West argues that the "high capacity" market defines a relevant product market because these circuits "share the characteristics of offering business, government, and carrier customers substantial bandwidth on a dedicated basis."¹⁰ The Commission has, however, never defined a distinct "high capacity" market for the purposes of market power analysis. Instead, the Commission has consistently defined

⁹See, e.g., Comsat Order at ¶25.

¹⁰U S West Petition at 11.

the relevant product market to be the larger "exchange access" market.¹¹ By limiting its petition for forbearance to the "high capacity market," even U S West apparently concedes that it remains dominant in the exchange access market as a whole. This would be consistent with the Commission's recognition that "virtually all local markets are dominated by the incumbent local exchange carrier."¹² It would also be consistent with MCI's recent report finding an absence of competition in the exchange access market.¹³

As discussed in greater detail below, even if the Commission were to accept for the purposes of this proceeding that "high capacity" services constitute a distinct product market, it is clear that U S West continues to possess market power for these services. Furthermore, U S West's market power over DS1 services is even more pronounced than its market power for DS3 or higher capacity services. The Quality Strategies report attached to U S West's petition points out that U S West's market share for DS1 services

¹¹In the Matter of Application of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications Corporation to WorldCom, Inc., Memorandum Opinion and Order, CC Docket No. 97-211, September 14, 1998, at ¶164 (WorldCom/MCI Order); Applications of Teleport Communications Group Inc. and AT&T For Consent to Transfer of Control of Corporations Holding Point-to-Point Microwave Licenses and Authorizations to Provide International Facilities-Based and Resold Communications Services, Memorandum Opinion and Order, CC Docket No. 98-24, Memorandum Opinion and Order, released July 23, 1998, at ¶20 (AT&T/TCG Order); Applications of NYNEX Corporation and Bell Atlantic Corporation for Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries, Memorandum Opinion and Order, File No. NSD-L-96-10, August 14, 1997 at ¶51 (Bell Atlantic/NYNEX Order).

¹²AT&T/TCG Order at ¶21; See also WorldCom/MCI Order at ¶168.

¹³Letter from Mary L. Brown, MCI, to Richard Metzger, FCC, CC Docket No. 96-262, RM 9210, May 7, 1998.

is substantially higher than its market share for DS3 services.¹⁴ This is due, in large part, to the fact that competitor networks are less developed on lower capacity routes, especially those outside the central business district.

2. Geographic Market

The Commission has found that each point-to-point market constitutes a separate relevant geographic market. The Commission has stated, however, that it will treat as a single relevant geographic market "an area in which all customers in that area will likely face the same competitive alternatives for a [relevant service]."¹⁵

Competitive conditions in the Phoenix MSA differ substantially from route to route. On a small number of routes in the central business district of Phoenix, CAPs may provide a competitive alternative. But on the vast majority of routes in the Phoenix MSA CAPs do not currently provide a competitive alternative and, contrary to U S West's claim that CAPs could serve these locations "in a timely fashion,"¹⁶ could not provide a competitive alternative absent significant investments. Thus, U S West has not demonstrated that the Phoenix MSA can be considered a relevant geographic market.

¹⁴Quality Strategies, "U S West High Capacity Market Study -- Phoenix Metropolitan Statistical Area," August 7, 1998, at 13 (Quality Strategies Report).

¹⁵Bell Atlantic/NYNEX Order at ¶54.

¹⁶U S West Petition at 13.

B. Market Power Assessment

In evaluating the incumbent carrier's market power in the AT&T and Comsat nondominance proceedings, the Commission looked at such factors as demand elasticity, supply elasticity, the incumbent's pricing behavior, market share, and differences in cost structures. When these factors are evaluated with reference to high-capacity services available in Phoenix, it is clear that U S West continues to possess market power.

1. Demand Elasticity of U S West's Customers

U S West argues that customers for high-capacity services in the Phoenix MSA are highly demand elastic, and will switch carriers in order to obtain price reductions and desired features. U S West points out that customers of high capacity services are large businesses, interexchange carriers, and other sophisticated buyers.

While MCI WorldCom and other access customers are obviously eager to find alternatives to U S West, a finding of high demand elasticity requires that U S West's customers not only be willing to switch suppliers, but also that they have the ability to do so.¹⁷ High-capacity customers in Phoenix currently have only a limited ability to switch suppliers. First, alternative sources of supply are simply unavailable on every route. Second, high-capacity customers in the Phoenix MSA often do not have the ability to switch suppliers because their high-capacity circuits are locked up in U S West term plans. For example, 48 percent of U S West's DS-3 special access circuits are currently

¹⁷See, e.g., Comsat Order at ¶71 ("High firm demand elasticity indicates that customers are willing and have the ability to switch to another service provider in order to obtain price reductions or desired features").

purchased under five-year or ten-year term plans.¹⁸ For customers with term plans, substantial termination liabilities and nonrecurring charges make switching suppliers uneconomic.

Because much of U S West's high-capacity demand is locked up in term plans, the Commission cannot find that high demand elasticity exists in the Phoenix MSA. U S West's competitors are at a severe disadvantage because they are competing only for new growth or that portion of U S West's high-capacity business that is not locked up in term plans. This limited market reduces competitors' ability to expand their networks and develop economies of scale. Furthermore, because U S West has tied up such a large part of the high capacity market in term plans, U S West has little incentive to reduce prices in response to the limited competitive entry that has occurred.

2. Supply Elasticity

One of the most important components of the Commission's market power assessments is its evaluation of supply elasticity. Supply elasticity refers to the ability of suppliers in a given market to increase the quantity of service supplied in response to an increase in price. A key issue in this proceeding is whether supply is sufficiently elastic to constrain U S West's unilateral pricing decisions in the provision of high-capacity services, i.e., whether competitors have or could quickly acquire the capacity to take

¹⁸Based on rate detail information provided with U S West's 1998 annual access filing.

away enough business from U S West to make unilateral price increases by U S West unprofitable.¹⁹

It is clear that the supply of high-capacity services in the Phoenix MSA is highly inelastic. First, more than 90 percent of U S West's high-capacity customer locations currently do not have an alternative source of supply. In its petition, U S West cites statistics that show that competitors serve only a limited number of buildings in the Phoenix MSA: ELI has 30-45 buildings on its network, GST has 15-25 buildings on its network, MCI WorldCom (including MFS) has approximately 75-85 buildings on its network, and TCG has approximately 150 buildings on its network.²⁰ Because some of these buildings are served by more than one CAP network, MCI WorldCom estimates that no more than 200 buildings in the Phoenix MSA are connected to a competitor's network, or approximately 6 percent of the 3101 high capacity locations in the Phoenix MSA.²¹

Other evidence shows that competitive sources of supply are extremely limited. Of the approximately 70 central offices in the Phoenix MSA, only 2 have operational CAP collocations. Without operational collocations, there can be no competitive source of supply for switched transport between serving wire centers in the Phoenix MSA and

¹⁹See AT&T Reclassification Order, 11 FCC Rcd at 3303.

²⁰U S West Petition at 14-16.

²¹The Power Engineering study provided with U S West's petition shows 3101 high-capacity locations in the Phoenix MSA. U S West Petition, Attachment B, page 3.

U S West's end offices. Furthermore, without collocation sites CAPs are unable to use unbundled loops to provision DS1 special access circuits.

Recognizing that competitors do not currently provide alternative sources of supply on most routes, U S West attempts to argue that competitors could quickly acquire such a capability. It claims (incorrectly, in MCI WorldCom's view) that competitors can build out to a significant number of high-capacity locations "almost immediately, incurring only minimal costs."²²

U S West's argument -- that CAPs can build out their networks relatively easily, and that supply elasticity is therefore high -- is without basis. First, the Power Engineering cost study provided with U S West's petition substantially underestimates the cost of adding an additional building to a CAP network. It ignores several categories of costs, including (1) the cost of the add-drop multiplexer or other node used to connect the CAP fiber ring to the building's fiber link; (2) the cost of inside wiring; (3) building entrance fees that CAPs, but not U S West, typically must pay to building owners; and (4) the inflated costs of collocating in U S West end offices, if the CAP seeks to compete for U S West's switched transport business. Whereas the Power Engineering study estimates the average cost of adding a building to a CAP network to be \$29,596,²³ when the building is less than 1,000 feet from the CAP's fiber ring, MCI WorldCom's experience indicates that the true cost is at least four times greater. Proving in selective expansion of a CAP network is therefore geometrically more difficult than U S West

²²U S West Petition at 27.

²³Power Engineering Study at 3.

suggests, since a CLEC's ability to generate revenues from a given building must be commensurate with the cost of serving that building.

Second, U S West substantially underestimates the time required to add a building to a CAP network. Whereas the Power Engineering study focuses only on construction time, and estimates that a location can be added in two weeks, in MCI WorldCom's experience the time required to add a new building to its local network is substantially longer -- three months or more. Not only has Power underestimated the construction time, but it has ignored the time required to plan and engineer the new link and the time consuming process of negotiating rights-of-way, obtaining necessary permits, and negotiating with building owners

Third, U S West makes the unrealistic assumption that CAPs would devote a disproportionate share of their resources to the Phoenix market. CAPs are simultaneously trying to establish themselves in many other local markets, all of which are dominated by the incumbent LEC.²⁴ On a national scale, massive amounts of capital would be necessary for CAPs to build out their networks sufficiently rapidly to constrain ILEC high-capacity pricing in all of these cities. U S West's claim that CAPs can build out their networks sufficiently rapidly to constrain U S West's high capacity pricing in Phoenix therefore appears to rest on an assumption that CAPs would devote a disproportionate share of their resources to the Phoenix market. This narrow focus on the Phoenix market illustrates the dangers of analyzing the issues raised by U S West on a city-by-city basis rather than in a comprehensive rulemaking.

²⁴AT&T/TCG Order at ¶26.

It is noteworthy that U S West's analysis of supply elasticity assumes that new entrants will have to provide service using an exclusively facilities-based strategy. The Telecommunications Act of 1996 provided for alternative market-entry paths that, in theory, could accelerate entry into at least the DS1 portion of the high-capacity market. A competitor could, for example, use unbundled loops and collocated transmission equipment in providing competitive DS1 special access services. Collocation at U S West's central offices is also necessary if a CAP is to compete in the market for switched transport services. As U S West apparently recognizes, however, collocation space and unbundled loops that U S West has priced well above forward-looking economic cost, coupled with the lack of functional OSS, are forcing competitors to use the capital-intensive and time-consuming path of facilities-based entry.

In no respect is the supply elasticity for high-capacity services in Phoenix comparable to the supply elasticity the Commission found in the AT&T or Comsat nondominance proceedings. In the AT&T nondominance proceeding, the record showed that AT&T's competitors could immediately absorb 15 percent of AT&T's total switched demand, could absorb one-third of AT&T's capacity with existing equipment, and could absorb two-thirds of AT&T's capacity within a year after investing only \$660 million.²⁵ By contrast, U S West's competitors in the Phoenix market currently serve only 6 percent of U S West's high capacity locations, can absorb zero demand on most routes, can provide service to additional locations only by constructing new facilities, and can address a significant fraction of U S West's high capacity market only by

²⁵AT&T Reclassification Order, 11 FCC Rcd at 3303.

making investments that, when extrapolated to a national scale, would cost billions of dollars.

It is clear, therefore, that the Phoenix high capacity market is subject to an inelastic competitive supply, which requires customers to use U S West's high-capacity services on the vast majority of routes in the Phoenix MSA. Competitive networks are in the early stages of their development, and are unable to constrain U S West's pricing of high-capacity circuits or to constrain U S West's ability to discriminate unreasonably in the provision of high-capacity circuits.

3. U S West's Pricing Behavior

The Commission has, on various occasions, examined the incumbent's pricing behavior to determine whether such pricing behavior was consistent with declining market power. In the AT&T nondominance proceeding, for example, the Commission noted that AT&T's Basket 1 API was 6.2 percent below the PCI.²⁶

U S West's pricing behavior is consistent with a carrier that continues to possess market power. First, U S West continues to price its trunking basket services at the maximum permitted by the price cap rules. Any declines in U S West's high capacity rates have thus been due not to the effects of competition, as U S West claims, but solely due to the operation of the X-Factor. Indeed, in the most recent annual access filing, when the Commission's rules required U S West to target all X-Factor reductions to the

²⁶AT&T Reclassification Order, 11 FCC Rcd at 3314.

Transport Interconnection Charge (TIC),²⁷ and none to the High-Cap service categories. U S West actually increased its interstate high-capacity rates.²⁸ Obviously, these price increases are inconsistent with U S West's claims of growing competition. There is absolutely no evidence that the cost of providing high-capacity services is increasing; indeed, there is substantial evidence that the cost of providing high-capacity services is declining.²⁹

Second, U S West has utilized little of the zone pricing flexibility that it has been granted by the Commission. Under the Commission's rules, U S West is permitted to establish a reasonable number of density pricing zones for high-capacity services in the Arizona study area. U S West has, in fact, established three such zones. With one very limited exception, however, U S West charges the same rates for high-capacity services in the presumably more competitive Zone 1 as in the other two zones.³⁰ U S West's failure to use the pricing flexibility that it has been granted is also inconsistent with its claims of growing competition in the Phoenix MSA.

²⁷47 C.F.R. §61.47(I).

²⁸In the most recent annual filing, U S West's DS-1 subcategory SBI increased from 80.7337 to 85.1531, while its DS-3 SBI increased from 86.5631 to 101.2373. U S West Tariff F.C.C. No. 5, Transmittal No. 928, June 29, 1998, Chart IND-1, columns (C), (G).

²⁹The growing use of HDSL technology is reducing the cost of provisioning DS1 circuits. See Fiber Deployment Update - End of Year 1997, Industry Analysis Division, at 20; Table 8.

³⁰U S West has different zone rates for DS1 channel terminations, but DS1 mileage rates and all DS3 rates are the same in all three zones.

Furthermore, U S West's service quality is declining. As shown by U S West's ARMIS 43-05 Service Quality reports, U S West's service quality declined substantially between 1996 and 1997. Whereas in 1996 U S West's average installation interval for switched access circuits was 18.8 days, in 1997 the average installation interval was almost twice as long -- 32.7 days.³¹ Similarly, the average installation interval for special access circuits increased by 50 percent, from 14.2 days to 22.1 days.³² The decline in service quality shown by U S West's ARMIS 43-05 reports is consistent with MCI WorldCom's experience as a U S West customer, and is inconsistent with U S West's contention that competition for high capacity services in Phoenix is increasing.

4. Market Share

U S West cites a variety of market share statistics in support of its argument that it no longer dominant in the provision of high capacity services in Phoenix. However, the market share measures cited by U S West are either meaningless or misleading.

First, U S West places great weight on a statistic it describes as the "retail" market share for high-capacity services.³³ The "retail" market to which U S West refers apparently consists of high capacity services ultimately purchased by end users, both high capacity facilities sold directly to end users by U S West or a CAP and special access facilities provided to end users by IXC's. U S West claims that it has only a 30

³¹ARMIS 43-05, col. aa, row 121.

³²Id., row ac.

³³U S West Petition at 19, 22.

percent market share of the "retail" market, with the remaining 70 percent provided to end users by IXC's or CAP's.

This market share figure is meaningless. Nearly all of the 70 percent market share that U S West attributes to "competitors" consists of U S West circuits ordered from IXC's (rather than directly from U S West). It has always been true that most ILEC special access circuits are ordered from the IXC, rather than from the ILEC. Most customers look to the IXC to provision an end-to-end arrangement since the transaction costs associated with obtaining access and long distance separately are not insubstantial. The fact that an end user may order a U S West circuit from an IXC does not transform the IXC into a competitor in the special access market or demonstrate a decline in U S West's market power. In fact, according to U S West's logic, it had "lost" most of the "retail" market for high-capacity services even before a single CAP network was built in the Phoenix MSA.³⁴

U S West contends that the practice of ordering special access circuits from the IXC rather than directly from the ILEC is significant because resellers can exercise pricing discipline.³⁵ This is not true of IXC's role in providing high-capacity services. The IXC is, in most respects, simply acting as an agent for the end user, not exploiting

³⁴MCI WorldCom estimates that circuits ordered from IXC's represent approximately 85 percent of U S West's interstate high-capacity revenues. U S West's TRP shows approximately \$500 million in annual "DDS and High-Cap revenues" (SUM-1, line 200); U S West's most recent USF-related PCI adjustment filing shows \$85 million in "DDS and High-Cap" end user revenues (Transmittal No. 945, Workpaper 1, page 2).

³⁵U S West Petition at 20.

differences between high volume and low volume rates in the same manner as resellers in the interexchange and wireless markets. The Commission has, in any event, never found the longstanding practice of ordering special access circuits from IXC's to be of any competitive significance.

The other market share statistics cited by U S West, which correctly treat IXC's as customers rather than competitors, show that U S West continues to dominate the provision of high-capacity services in Phoenix. According to U S West, it has an overall 77 percent share of the "high-capacity market" in the Phoenix MSA. U S West reports that it controls 71.7 percent of the "provider market" (i.e., high capacity services ultimately purchased by end users), 79.1 percent of the "wholesale market" (i.e., high capacity circuits sold to IXC's), and 84.1 percent of the "transport market" (i.e., high capacity circuits sold to IXC's for transport services).

Even these figures tend to understate the degree to which U S West dominates the provision of high capacity services. U S West's market share figures are expressed in "DS1 equivalents," an approach that has the effect of attributing greater share gains to CAPs than if a revenue-based market share measure is used. DS3 circuits, for which there is somewhat more competition than for DS1 circuits, are given greater weight in a "DS1 equivalent"-based market share analysis than in a revenue-based market share analysis.³⁶ Even if it is true that U S West's overall market share is 77 percent on a DS1-equivalent basis, it is likely that U S West's overall Phoenix MSA share is over 90

³⁶A DS-3 is 24 "DS1 equivalents," but revenue from a DS3 equals the revenue from only approximately 10 DS1s.

percent when measured on a revenue basis. In the Phoenix MSA, U S West currently receives over 90 percent of MCI's high-capacity access payments.

Regardless of whether a DS1-equivalent or revenue market share measure is used, U S West's market share in the Phoenix high capacity market is inconsistent with U S West's claim of lost market power. Even the 77 percent DS1-equivalent market share figure is substantially higher than AT&T's share of the long distance market when the Commission found AT&T to be non-dominant. In the AT&T Reclassification Order, the Commission found that AT&T's market share had fallen to 55.2 percent in terms of revenues and 58.6 percent in terms of minutes.³⁷

5. Cost Structure, Size and Resources

As the incumbent provider of high-capacity services in the Phoenix MSA, U S West enjoys several cost advantages. First, as the Commission has observed, CAPs are attempting to enter a market that is dominated by the incumbent provider, and may not have attracted a sufficient amount of business to achieve economies of scale.³⁸

Second, one of the most important factors inhibiting CAPs from expanding their networks to serve additional buildings is the refusal of most landlords to allow CAPs to provide service in their building without payment of compensation — compensation that is almost never demanded from the ILEC. This places CAPs at a competitive

³⁷AT&T Reclassification Order, 11 FCC Rcd at 3307.

³⁸In the Matter of Southwestern Bell Telephone Company, Tariff F.C.C. No. 73, Order Concluding Investigation and Denying Application for Review, 12 FCC Rcd 19311, 19337 (1997) (SWBT RFP Tariff Rejection Order).

disadvantage in terms of the cost of providing service. Furthermore, the CAPs must make a difficult decision regarding the allocation of scarce capital. Ideally, given the necessity of paying building owners, the CAP would prefer to make the commitment to enter a building only after obtaining contracts to provide service to customers in that building. But given that the process of obtaining authority to enter a building after signing up a new contract may take months, CAPs may risk capital by committing to certain buildings prior to having a signed customer contract. Others will wait for the customer contract, but the resulting lengthy time for delivery of service will make the sales efforts more difficult.

C. U S West Continues to Possess Market Power in the Phoenix Market for High Capacity Services

In determining whether a carrier has market power, the Commission analyzes whether the carrier has the ability to “raise prices above competitive levels and maintain that price for a significant period, reduce the quality of the relevant product or service, reduce innovation or restrict output profitably”³⁹ Applying this standard to the evidence discussed above, it is clear that U S West continues to possess market power in the Phoenix area market for high capacity services. As discussed above, (1) there are no real competitive alternatives to U S West for the vast majority of routes in the Phoenix MSA; (2) competitors cannot provide service to additional locations without substantial investments of time and money; (3) U S West’s market share remains robust; (4) U S

³⁹See Comsat Order at ¶67.